

Message Text

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ACTION AF-10

INFO OCT-01 ISO-00 AID-05 CIAE-00 COME-00 EB-08 FRB-03
INR-10 NSAE-00 ICA-11 TRSE-00 XMB-02 OPIC-03
SP-02 LAB-04 SIL-01 OMB-01 NSC-05 SS-15 STR-07
CEA-01 AGRE-00 DOE-15 SOE-02 /106 W
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R 300922Z AUG 78
FM AMEMBASSY NAIROBI
TO SECSTATE WASHDC 0171
INFO AMEMBASSY ADDIS ABABA
AMEMBASSY DAR ES SALAAM
AMEMBASSY KHARTOUM
AMEMBASSY MOGADISCIO
AMEMBASSY LUSAKA
AMEMBASSY VICTORIA

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PASS DOC, DID, EXIM, OPIC

E. O. 11652: N/A
TAGS: ECON, EFIN, KE
SUBJECT: FIRST QUARTER 1978 DATA INDICATE ECONOMIC DOWNTURN

REF: NAIROBI A-55

1. SUMMARY: RECENTLY RELEASED FIRST QUARTER 1978
ECONOMIC DATA DEPICT A DOWNWARD TREND FOR ALMOST ALL
ECONOMIC MEASURES COMPARED TO THE FIRST QUARTER LAST
YEAR. A 37 PERCENT RISE IN IMPORTS AND AN 18 PERCENT
DECLINE IN EXPORTS CAUSED A 157 MILLION DOLLAR TRADE
DEFICIT THIS YEAR COMPARED TO A 23 MILLION DOLLAR SURPLUS
IN 1977. OVERALL BALANCE OF PAYMENTS ALSO FELL INTO
DEFICIT AFTER REGISTERING A SURPLUS LAST YEAR. EXPORT
PERFORMANCE HAS SUFFERED MOST FROM THE SHARP DECREASE
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IN WORLD COFFEE PRICES BUT OTHER MAJOR EXPORT
COMMODITIES HAVE ALSO DECLINED. CONSUMER GOODS
HAVE LED IMPORT ADVANCE. IN PART REFLECTING THIS
FOREIGN TRADE SITUATION, THE DOMESTIC ECONOMY
SHOWED UNEVEN PERFORMANCE. AGRICULTURAL OUTPUT WAS
UNEVENLY DISTRIBUTED AMONG COMMODITIES AND THE
MANUFACTURING SECTOR ALSO SHOWED MIXED RESULTS. THE

SLOWDOWN IN THE DOMESTIC ECONOMY DID MODERATE THE INFLATION RATE WHICH IS ESTIMATED AT 14.7 PERCENT OMR THE QUARTER COMPARED TO 16 PERCENT LAST YEAR. PRELIMINARY DATE FOR THE SECOND QUARTER INDICATE A CONTINUATION OF THE DOWNWARD TREND AND KENYA IS EXPECTED TO REGISTER LARGE TRADE AND BALANCE OF PAYMENTS DEFICITS IN 1978. CONTINUED STRONG DOMESTIC DEMAND WILL EXERT PRESSURE ON PRICES AND INFLATION WILL BE A MAJOR PROBLEM FOR THE RE-MAINDER OF THE YEAR. WHILE NO MAJOR CHANGES IN GOK ECONOMIC POLICIES ARE ANTICIPATED, THE DEATH OF PRESIDENT KENYATTA AND THE TRANSITIONAL POLITICAL PROCESS WILL CREATE UNCERTAINTIES WHICH MAY CAUSE INVESTORS TO HOLD BACK UNTIL THE POLITICAL SCENE BECOMES CLEARER. END OF SUMMARY.

2. THE CENTRAL BANK OF KENYA(CBK) RECENTLY RELEASED STATISTICAL DATA FOR THE FIRST QUARTER 1978. COMPARED TO THE FIRST QUARTER OF LAST YEAR, ALMOST ALL INDICATORS SHOW A DOWNWARD TREND. THE TRADE AND BALANCE OF PAYMENTS FIGURES,IN PARTICULAR, SHOW A MARKED DETERIORATION FROM LAST YEAR'S PERFORMANCE. KENYA'S OVERALL BOP DEFICIT FOR THE FIRST QUARTER 1978 WAS 13 MILLION DOLLARS COMPARED TO AN OVERALL SURPLUS OF 118 MILLION DOLLARS IN THE SAME PERIOD LAST YEAR. THE MERCHANDISE TRADE BALANCE SLIPPED FROM A 23 MILLION DOLLARS LIMITED OFFICIAL USE

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SURPLUS IN THE FIRST QUARTER 1977 TO A DEFICIT OF 157 MILLION DOLLARS THIS YEAR.

3. THE REASONS FOR THE DETERIORATION IN TRADE PERFORMANCE ARE READILY APPARENT. IN THE FIRST QUARTER 1978, IMPORTS WERE 37 PERCENT HIGHER THAN LAST YEAR, WHILE EXPORTS DECLINED BY 18 PERCENT. THE FALL IN WORLD COFFEE PRICES IS THE PRIMARY CAUSE OF THE DECLINE IN EXPORT EARNINGS(COFFEE PRICES FELL EVEN LOWER DURING THE SECOND QUARTER OF THE YEAR, INDICATING CONTINUED DETERIORATION IN KENYA'S TRADE ACCOUNTS). FURTHER, EXCEPT FOR TEA AND PETROLEUM PRODUCTS, ALL OF KENYA'S OTHER MAJOR EXPORTS(SISAL, PYRETHRUM, AND MEAT) REGISTERED DECLINES. THE QUARTER'S EXPORT PERFORMANCE WAS KEPT FROM BEING WORSE BY HIGH TEA PRICES AND A SHARP INCREASE IN EXPORTS OF PETROLEUM PRODUCTS(42 MILLION DOLLARS IN 1978 VERSUS 22 MILLION DOLLARS IN 1977).

4. THE IMPORT SURGE WAS LED BY CONSUMER GOODS. CATEGORIES REGISTERING INCREASES SIGNIFICANTLY HIGHER THAN THE TOTAL WERE MACHINERY AND TRANSPORT

EQUIPMENT(PRIMARILY PASSENGER AUTOMOBILES), CHEMICALS,
FOOD PRODUCTS, AND BEVERAGES AND TOBACCO. ACCORDING
TO THE CBK, THIS TREND CONTINUED THROUGH THE SECOND QUARTER.
THUS, MUCH OF THE LARGE FOREIGN EXCHANGE
RESERVES ACCUMULATED IN 1977(535 MILLION DOLLARS AT
YEAR-END) HAVE BEEN UTILIZED TO SUPPORT LUXURY GOODS
PURCHASES ESTIMATED AT CLOSE TO 400 MILLION DOLLARS
BY MID-YEAR 1978.

5. INVISIBLES, WITH A FAVORABLE BALANCE OF OVER 140
MILLION DOLLARS, HELPED OFFSET THE DETERIORATION IN THE
TRADE ACCOUNTS. CAPITAL MOVEMENTS AND EARNINGS FROM
TOURISM CONTRIBUTED MOST IMPORTANTLY TO THE POSITIVE
INVISIBLES BALANCE. DUE TO A QUOTE BOOM UNQUOTE.
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JANUARY-MARCH PERIOD ON THE COAST, FOREIGN EXCHANGE
RECEIPTS FROM TOURISM GREW 7.4 PERCENT OVER THE FIRST
QUARTER 1977(FROM 34 MILLION DOLLARS TO 39 MILLION
DOLLARS) AND FOREIGN BED-NIGHTS INCREASED BY 7.5 PERCENT.

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6. THE POOR EXPORT PERFORMANCE IN THE FIRST QUARTER WAS PARTIALLY RESPONSIBLE FOR A MIXED PERFORMANCE BY THE DOMESTIC ECONOMY. AGRICULTURAL OUTPUT WAS UNEVENLY DISTRIBUTED WITH MOST MAJOR CASH CROPS AND FOOD COMMODITIES REGISTERING DECLINES OR ONLY SLIGHT GAINS. COFFEE OUTPUT INCREASED BY 2.8 PERCENT OVER THE SAME PERIOD LAST YEAR, WHILE WHEAT, SISAL, AND MEAT DECLINED (BY 23, 11, AND 78 PERCENT RESPECTIVELY). TEA AND MILK WERE THE ONLY AGRICULTURAL COMMODITIES TO SHOW SIGNIFICANT OUTPUT INCREASES. THE MANUFACTURING SECTOR DISPLAYED A SIMILAR UNEVEN PERFORMANCE. MOST PROCESSED FOOD PRODUCTS INCREASED OUTPUT BUT CONSUMER MANUFACTURES (EXCEPT BEER AND CIGARETTES) REGISTERED DECLINES INDICATING A MARKED PREFERENCE FOR IMPORTED CONSUMER GOODS BY KENYANS WHO CAN AFFORD SUCH ITEMS.

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7. THESE DEVELOPMENTS IN THE DOMESTIC ECONOMY DID MODERATE THE INFLATION RATE SOMEWHAT. THE CBK ESTIMATES THE FIRST QUARTER 1978 INFLATION RATE AT 14.7 PERCENT COMPARED TO 16.3 PERCENT LAST YEAR. THE NAIROBI PRICE INDICES FOR THE LOWER, MIDDLE, AND UPPER INCOME GROUPS ALL SHOW SLOWER RATE OF INCREASE IN THE FIRST QUARTER THIS YEAR THAN THOSE RECORDED LAST YEAR IN THE SAME PERIOD. HOWEVER, THE CBK ESTIMATES THAT INFLATION HEATED UP IN THE SECOND QUARTER OF THE YEAR, SPURRED BY HEAVY GOVERNMENT SPENDING IN THAT QUARTER.

8. COMMENT: THE HARD DATA NOW AVAILABLE CONFIRM THE VIEW OF MOST ECONOMIC ANALYSTS HERE THAT 1978 WILL BE A DIFFICULT YEAR ECONOMICALLY. IT IS TRUE THAT THE PUBLISHED FIGURES COVER ONLY ONE QUARTER BUT PRELIMINARY DATA FOR THE SECOND QUARTER SHOW A CONTINUATION OF THE OVERALL DOWNWARD TREND. THE ONE EXCEPTION APPEARS TO BE CONSTRUCTION ACTIVITY WHICH IS BENEFITING FROM THE INCREASED BUILDING APPROVALS GRANTED IN 1977 WHEN THE ECONOMY WAS FLUSH WITH COFFEE MONEY. SHOULD THE TRENDS ESTABLISHED IN THE FIRST QUARTER CONTINUE (AND WE EXPECT THEY WILL), 1978 WILL END WITH A TRADE DEFICIT OF SOME 400 MILLION DOLLARS AND AN OVERALL BOP DEFICIT OF AROUND 80 MILLION DOLLARS. THE GDP GROWTH RATE WILL SLIP MARKEDLY FROM THE 7 PERCENT REGISTERED IN 1977. MANY ANALYSTS ARE PREDICTING A 1978 GROWTH RATE IN THE 3-4 PERCENT RANGE. IF THE POPULATION GROWTH RATE CONTINUES AT ITS CURRENT

LEVEL(3-4PERCENT), PER CAPITA INCOME WILL REMAIN
STATIC. SHOULD HEAVEY GOVERNMENT DOMESTIC BORROWING
SHARPLY CONSTRICT THE CREDIT AVAILABLE TO THE PRIVATE
SECTOR, WE COULD WELL SEE AN EVEN LOWER GROWTH RATE.
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THE GOVERNMENT IS EXPECTED TO ABSORB MUCH OF THE
AVAILABLE CREDIT IN FINANCING ITS FY 78 AND FY 79 BUDGET
DEFICITS, AND THE CBK HAS PLACED RESTRICTIONS ON COMMER-
CIAL BANK PRIVATE SECTOR LENDING. IT IS THEREFORE
QUITE CONCEIVABLE THAT A SHORTAGE OF CREDIT WILL DEVELOP
OVER 1978 AND INTO 1979. HIGH INFLATION WILL SERVE TO
EXACERBATE THESE DIFFICULTIES. ALHTOUGH THE GROWTH
IN MONEY SUPPLY HAS MODERATED SOMEWHAT OVER THE FIRST
HALF OF 1978(IT IS ESTIMATED AT AROUND A 25 PERCENT
ANNUAL RATE), IT IS STILL HIGH AND CONTRIBUTING
TO INFLATIONARY TENDENCIES. THE HIGH BANK LIQUIDITY
OF 1976 AND 1977 HAS ALSO FALLEN THIS YEAR. IT
APPEARS LIKELY THAT THE MAJOR FINANCIAL PROBLEM FOR
BANKS IN 1978 WILL BE INSUFFICIENT RESROUCES(OR,
MORE CORRECTLY, LENDING RESTRICTIONS) RATHER THAN TOO
MUCH MONEY. DOMESTIC DEMAND IS EXPECTED TO REMAIN
STRONG THROUGHOUT THE YEAR AS SPENDABLE INCOMES EARNED
IN 1977 REMAIN HIGH. THE HIGH DEMAND COUPLED WITH
LOWER OUTPUT FOR SOME COMMODITIES WILL EXERT STRONG
UPWARD PRESSURE ON PRICES THROUGHOUT THE REMAINDER
OF THE YEAR AND AN INFLATION RATE IN THE NEIGHBORHOOD
OF 20 PERCENT IS NOT INCONCEIVABLE.

9. THE DEATH OF PRESIDENT KENYATTA CASTS ANOTHER
SHADOW OF UNCERTAINTY OVER THE KENYAN ECONOMY FOR THE
REAST OF THE YEAR. WE EXPECT NO MAJOR SHIFTS IN GOK
ECONOMIC POLICIES AND ARE ENCOURAGED BY PRESIDENT MOI'S
PUBLICALLY STATED COMMITMENT TO PURSUE PRESIDENT KENYATTA'S
POLICIES AND HIS SENDING THE KENYAN AMBASSADOR TO WASHINGTON
WITH A SPECIAL MESSAGE EMPHASIZING THAT PRIVATE FOREIGN
INVESTMENT WILL CONTINUE TO BE PROTECTED AND SOUGHT.
ALSO, A CONSTITUTIONAL SUCCESSION APPEARS LIKELY.
HOWEVER, THE POLITICAL TRANSITION COULD CREATE A DEGREE
OF HESITANCY AMONG BUSINESSMEN. THERE COULD BE AN
ADVERSE IMPACT ON INVESTMENT FOR THE SHORT-TERM, AS
POTENTIAL INVESTORS HOLD BACK UNTIL THE NEW POLITICAL
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ALIGNMENTS AND POWER CENTERS BECOME CLEAR. AT THE
MOMENT WE CAN SEE FEW SIGNS OF SUCH HESITANCY, BUT

WOULD NOT BE UNREASONABLE FOR PRUDENT INVESTORS TO
AWAIT THE OUTCOME OF THE TRANSITIONAL POLITICAL PROCESS
BEFORE COMMITTING THEMSELVES.
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